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No. 80-1464

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

JAMES G. WATT, SECRETARY OF THE INTERIOR, ET AL.,
Petitioners

v.

ENERGY ACTION EDUCATIONAL FOUNDATION, ET AL.,
Respondents

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENTS

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Whether the announced determination of the Secretary of Interior to make no use of any of the three non-bonus bidding systems among the six new systems specified by the 1978 OCSLA amendments, violates the statute's mandate that for five years the new systems "shall be applied" in OCS sales, and defeats the central Congressional objective to test systems that could enhance bidding competition and smaller company participation on the OCS.

2. Whether the Secretary's refusal to test the profit share bidding system long successfully and profitably used by California, violates the statute's requirement that leasing shall "assure receipt of fair market value" return.

3. Whether the court below correctly found that the California State offshore leasing agencies and the consumer plaintiffs suffer adverse effects and have standing to object that the Secretary is unlawfully refusing to use the new non-bonus bidding systems specified in the statutory amendments.

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BRIEF FOR RESPONDENTS

The studied dullness of the Government's brief to this Court cannot obscure the overwhelming significance of the issue at stake. The unanimous ruling below prevents the Government's attempted nullification of the 1978 statutory reforms in OCS leasing, enacted after careful and extensive consideration and over the objections of the major oil companies. It permits accomplishment of the vital Congressional purposes of greater competition in OCS leasing and a better return to the nation for our most important natural resources, and could mean billions in revenue to the public Treasury and higher yields to plaintiff California and other states similarly situated. These beneficial effects sought by Congress and secured by the Court of Appeals now rest upon this Court's affirmance of the ruling below.

COUNTER-STATEMENT

1. When Congress enacted the 1953 Outer Continental Shelf Lands Act, it provided that offshore properties could be leased either by bidding of cash bonuses to be paid for a pre-fixed royalty lease, or by bidding of the royalty payable to the Government for a pre-fixed cash bonus lease. Few companies other than the major oil producers have the cash reserves to compete effectively in cash bonus auctions, but from the beginning the Department of Interior yielded to the demands of the major companies for exclusively cash bonus bidding. Between 1954 and 1978 nearly all the leases were thus acquired by the major oil producers, with little competitive bidding among them for individual leases. The Congressional reports noted these adverse results of bonus bid leasing and proposed the 1978 OCSLA amendments as "a new statutory regime for the management of the oil and natural gas resources of the Outer Continental Shelf" (H. Rept. 95-590, 95th Cong., 1st Sess. 53 (1977)).

2. A major factor prompting enactment of the 1978 amendments was concern over the adverse results of bonus bid leasing. For example, the House Report stated (*id.* at 47): "At present, the cash bonus system is used almost exclusively. Under that system, in order to win a lease, a company must have vast amounts of capital, and the price to the company is set without full knowledge of the value of the oil and gas in the area. This may reduce competition for offshore leases to the major oil companies and reduce the public return for resources." The Report concluded (at 54) that "there is now doubt whether cash bonus bidding remains the best system for the future," and that there was therefore a need "to authorize alternative leasing arrangements and require experimentation with them." The Senate Report evidenced identical concerns (S. Rept. 95-284, 95th Cong., 1st Sess. 46 (1977)).

3. Hopeful that new untried leasing methods would prove more beneficial, in Section 205(a)(5)(B) Congress mandated a five-year experimental leasing program wherein annually "the bidding systems authorized by paragraph (1) . . . *shall be applied* to not less than 20 per centum and not more than 60 per centum of the total area offered for leasing . . ." (43 U.S.C. § 1337(a)(5)(B), emphasis supplied). In addition to the traditional bonus bidding system, the statute sets forth three new systems still using bonus bidding and three new systems using other bid elements (43 U.S.C. § 1337(a)(1)). The new *non-bonus bid systems* include 1) royalty bidding for fixed cash bonus leases (Section (a)(1)(B)), work commitment bidding for fixed cash bonus leases (Section (a)(1)(G)), and net profit share bidding for fixed cash bonus leases Section (a)(1)(D)). The last of these is the system California has successfully used for over 30 years, with far greater public returns than the Federal Government has received under bonus bid leasing (see H. Rept. 94-1084, 94th Cong., 2d Sess. 249-50 (1976)). Congress also adopted a requirement (43 U.S.C. § 1344(a)(4)) that OCS leasing activities "shall be conducted to assure receipt of fair market value"—a requirement which responded to a series of critical Comptroller General reports issued between 1975 and 1978 (see Appendix C *infra* p. 4a), finding that in view of the tepid bid competition for leases having no reliably predictable resource value, there was no assurance that fair public return was obtained from bonus bid leasing.

4. Nine months after enactment of the 1978 provisions no new bidding system regulation had issued, and DOI continued with its exclusively bonus bid leasing. When it thus appeared that the experimental leasing program might be defeated by administrative inaction, California oil lands authorities and consumers of oil joined as plaintiffs in bringing this suit to compel issuance and use of regulations for the important new leasing systems. Plain-

tiffs immediately sought a preliminary injunction urging that the statute's "fair market value" requirement was being violated by continued use of unprofitable bonus bid leasing instead of resort to the profit share bidding by which California has achieved greater public returns. On December 20, 1979, after the Government represented that new bidding regulations were soon being issued, the Court of Appeals declined to grant preliminary relief to plaintiffs. However, the Court warned that further delay in issuing the new regulations "may constitute a violation of the OCS Act amendments" (Petition for Certiorari, App. D at 97a).

5. Thereafter it became clear that there was not only further delay but outright defiance by defendants, for in 1980 the Government confessed that it had no plans at all for using any non-bonus bid leasing or even for issuance of the profit share bidding regulations (*id.*, App. A at 19a-20a). Accordingly, on October 30, 1980 the Court of Appeals found that the Government's refusal to publish regulations for the new non-bonus bid leasing systems was an abuse of discretion which frustrates the essential purposes of Congress in mandating an experimental program to test important new bidding systems (*id.* at 2a). In particular the Court found that to meet the central purpose of the experimentation mandate, the Secretary cannot confine testing to the bonus bid options (*id.* at 29a, 31a, 41a), and that at least profit share bidding must be tested in good faith during the five year program (*id.* at 44a-46a, 47a). The Department of Energy has since promulgated the regulations for two new non-bonus systems; the profit share bidding regulation was published on June 2, 1981 (46 Fed. Reg. 29680) and the work commitment bidding regulation was issued on July 9, 1981 (46 Fed. Reg. 35614).

6. In the fourteen OCS lease sales held during the three years since enactment of the 1978 reforms, the traditional cash bonus system and three bonus bidding

variants which DOI has used have not at all increased bidding competition or decreased the domination of the leases by the major oil companies. See Appendix A *infra*, p. 1a. Nevertheless, after this Court granted review Secretary Watt announced on May 8, 1981 (see Appendix B *infra*, p. 2a) that he will not in fact use either profit share bidding or work commitment bidding. Since DOI had earlier already concluded (see Petition for Certiorari, App. A at 19a, n. 44) that it would not use the third non-bonus bid system (royalty share bidding), this means that *unless the ruling below is affirmed there will be no non-bonus bid leasing at all during the entire five year experimental program.* The remaining two years would pass with the entire experiment—encompassing six new bidding systems identified by the statute—confined to varieties of bonus bid leasing to the exclusion of the three specified non-bonus bidding systems. We show in the Argument that such a curtailed resort to the new bidding systems specified by the statute defeats the important OCSLA reforms enacted in 1978.[1]

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[1] Contrary to the Government's claim, no question is now presented concerning defendants' duty to issue regulations. Plaintiffs' motion below sought an order for issuance of the profit share bidding regulation and its good faith use by the Secretary of Interior (see Amended Order attached to Plaintiffs' July 14, 1980 memorandum in the District Court). That is the promulgation and use which the Court below ordered (see Petition for Ceritorari, App. A at 49a, 44a-46a). Pursuant to a consent order entered by the District Court on December 19, 1980, the profit share bidding and work commitment bidding regulations have been finally promulgated. The only substantive question thus left for review arises from defendants' continued defiance of the lower court's ruling that the Secretary cannot confine the test program to bonus bidding systems, and must at least make good faith use of the net profit share bidding system.

SUMMARY OF ARGUMENT

I. *The Secretary's rejection of all three non-bonus bidding systems designated by the Congress violates the OCSLA requirement that the new bidding systems "shall be applied" to OCS sales during a five year experimental period.* Broad experimentation with the new systems was mandated by the statute, which commands that for five years, within annual minimum and maximum percentage limits the newly authorized systems "shall be applied" in OCS sales. That command does not permit rejection of half the new leasing systems without testing. The Senate Report explained the purpose to authorize new leasing systems and "require their use on an experimental basis", and to "assure" that these alternatives "will be used" and "would be tried." The House Report similarly described the purpose to "require experimentation" with the new systems, "mandating use of new systems, to insure they are tested and studied." The Conference Report likewise underscored that the new systems "are to be utilized" in all OCS areas for five years. The Secretary's refusal to test the non-bonus bidding half of the six new leasing systems also violates the expressed Congressional intent *to test the relative virtues of bonus and non-bonus bidding.* The House Report sought to compare results from "areas to be offered under a bonus bid system and those which would be offered under a non bonus bid system". The Conference Report likewise explained the need for testing "relative advantages and disadvantages of the various bidding systems, including the front-end bonus systems . . ."

The statute and its consistent legislative history thus repel the Secretary's contention that he has "discretion" to refuse to test any of the non-bonus bidding systems. For the discretion left the Secretary was not *whether* to test the new systems but only *where and when* to apply particular new systems to particular lease areas and tracts. Thus, the House Committee noted its intention

by the use of the new bidding systems "to determine what system or systems, in what situations, provide the best means to lease our federal resources in the Outer Continental Shelf." Similarly, the Conference Report explained that in requiring use of "a fair selection of different methods on different tracts," the intent was to assure adequate information on the advantages of various bidding systems "as applied to different types of tracts, having different expectations of the amount of hydrocarbons that can be recovered."

The Secretary's exclusive continued recourse to bonus bidding instead of using the new non-bonus bidding systems also defeats the expressed *objective* of the experimental program. Finding that there was inadequate competition under bonus bidding, and that smaller companies are precluded from succeeding in view of the onerous front-end bonus requirement, Congress sought testing of new systems which would increase competitive bidding and reduce domination of OCS leases by the major oil companies. That objective is totally defeated by the Secretary's rejection of the non-bonus bidding systems that could promote more bidding and participation by smaller companies. The Secretary's rejection is the less defensible considering that his use during the last three years of only bonus bidding options has yielded no improvement whatever in competition for the leases, no reduction in their domination by the major oil companies, and thus no progress in meeting the central purpose of the mandated experimental program.

II. *The Secretary's refusal to test the profit share bidding system is particularly unjustifiable in view of the statute's fair market value requirement.* The express requirement of the statute that leasing "shall be conducted to assure receipt of fair market value for the lands leased and the rights conveyed" cannot be met as long as the Secretary refuses to test the profit share bidding system which has long been used successfully

by California and with far greater public returns than bonus bidding has achieved for the Federal Government. The assured fair return requirement of the statute was a response to a series of five GAO reports preceding enactment of the statute; they emphasized repeatedly that given the unknown ultimate resource value of the properties, in the absence of active competitive bidding there is no assurance that the public receives a fair return from bonus bid leasing. The inadequate competition for bonus bid leases highlighted by the GAO has not at all improved since 1978. Yet the Secretary refuses to use or even test the profit share bidding system from which California has been realizing 25 cents more on each dollar of oil and gas revenue than the Federal Government realizes from bonus bid leasing. The Secretary's failure to test this most promising and established non-bonus bid system violates the statute's requirement that his leasing activities shall "assure" fair market value return for the public.

III. *Defendants' violations cause tangible injuries to plaintiffs which give them standing to seek relief under the statute's "Citizens Suits" section.* The liberal citizens suits provision of the statute authorizing suit by a person with an interest which "may be adversely affected" was intended to keep administrators "on their toes" by authorizing any interested party to vindicate the requirements of the statute. As a partner in federal lease revenues in OCS "drainage" situations, the California State plaintiffs have a direct monetary interest in the testing of new leasing systems expected to yield greater revenues. The same California plaintiffs also have standing as competitors with the Federal Government in the leasing of offshore properties, because the federal bonus bid leases, yielding far smaller payments by the lessee to the government from his oil and gas production, make it increasingly difficult for California profitably to lease its own properties and to maintain production and prices on its leases. Finally, the consumer plaintiffs also have standing because

they are denied the competition-promoting benefits which Congress sought by the new leasing systems, and because the major oil companies who acquire most of the bonus bid leases have a demonstrated capacity and tendency to hoard them with a consequent continuing threat of gasoline shortages adversely affecting the consumer plaintiffs.

ARGUMENT

I.

THE SECRETARY'S REFUSAL TO TEST ANY OF THE NON-BONUS BID SYSTEMS SPECIFIED BY THE STATUTE VIOLATES THE OCSLA'S MANDATE THAT THE NEW LEASING SYSTEMS SHALL BE APPLIED IN OCS SALES DURING THE FIVE YEAR EXPERIMENTAL PERIOD

The language, structure, and legislative history of the OCSLA amendments establish that there is an inescapable obligation upon the Secretary of Interior to experiment with leasing by non-cash bonus bidding. After 25 years of bonus bid leasing it had become clear by 1978 that the onerous front-end cash barrier severely limits the number of bidders and results in capture of most leases by the major oil companies, leaving no assurance that the public even receives a fair return for its immensely valuable resources.

To promote more active bidding and smaller company access to the OCS, the 1978 amendments identify six new leasing systems for testing and command that they "*shall be applied*" during a five year period of experimentation. Congress particularly sought to compare the results from new non-bonus bidding with the results from bonus bidding, in order to identify the systems best suited for use on particular offshore properties. We proceed to review the relevant legislative background and Congressional reports, which underscore that the Secretary's refusal to test any of the non-bonus bidding systems violates the

experimentation mandate of the statute and defeats its central remedial objective.

A. Leasing History

After rulings of this Court in the 1940s had upheld federal ownership of the outer continental shelf, Congress enacted the 1953 Outer Continental Shelf Lands Act and provided therein for alternative means of leasing. One option was the use of cash bonus bidding, by which the highest cash bidder acquires the lease and then pays the Government a fixed royalty representing a portion of the oil and gas he derives from the lease. A second basic alternative under the statute—which DOI has eschewed ever since 1953—was leasing to the bidder offering to the Government the highest rate of royalty return on his oil and gas production. Instead of royalty bidding, from the beginning in 1953 the Department of Interior chose bonus-bid leasing of OCS property with the same 16⅔% royalty rate previously used in onshore leasing.

In opting for bonus bid leasing of OCS properties of uncertain but potentially enormous oil and gas value, DOI followed the expressed preference of the major oil companies.[2] Thereby DOI rejected the alternative route which had already produced noteworthy benefits for the State of California. Congressional testimony by Attorney General Tom Clark had pointed as early as 1948 to the successful results of California's profit share leasing and urged its federal emulation (Title to Submerged Lands Beneath Tidal and Navigable Waters: Hearings on

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[2] From the first, these companies pressed for use of the cash auction system which most advantages them and eliminates smaller bidders. Thus, the President of Humble Oil testified that:

> "[1] leases should be awarded to responsible and qualified bidders upon the basis of the highest bonus payment offered. Rentals and royalties should not be subject to bidding but should be uniform and fixed in all leases." Hearings on H.R. 5991 and H.R. 5992 Before the House Judiciary Committee, 81st Cong., 1st Sess. 151 (1949).

S. 1988 and Similar House Bills Before the Senate Committee on the Judiciary and the House Committee on the Judiciary, 80th Cong., 2d Sess. 685). California has long experienced through use of royalty and profit share bidding a net return on the resulting leases representing nearly 50% of the oil and gas production value (JA 51-53). Under the bonus bid leasing DOI used in some 40 OCS lease sales held between 1953 and 1978, the United States realized far less return: about a 35% net return on oil and gas production leases before the 1970s; less than 30% on leases awarded since 1972; and from recent sales a federal return of only 22% (JA 125-45; 188-91; 206-23). The continuously declining federal return from bonus bid leasing reflects the astronomical rise in oil and gas prices which commenced at the beginning of the 1970s. The price rises have rendered the cash bonuses bid at the front end of the lease increasingly less valuable, adding constantly less to the basic fixed royalty rate.

In addition to diminishing public returns, bonus bidding had yielded little bid competition and much domination of OCS leases by the largest companies. In lease sales held prior to 1972 the average number of bids per tract offered was 1.71 (JA 40-41); per tract bid upon the average was only 3.5 (*id.*); and over 80% of all leases were acquired by the nation's twenty largest oil producers (JA 43-44). In sales between 1972 and 1978 the number of bids per tract offered declined to 1.26; per tract bid upon they decreased to 2.77; and the top 20 producers acquired between 67 and 87 percent of the tracts (JA 41-42, 44). Indeed, in the five years from 1968 to 1972 the twenty majors acquired successively 94%, 100%, 82%, 100% and 77% of the OCS leases sold (JA 44). These results were exacerbated in the 1970s, when vast increases commenced in DOI's annual leasing of OCS properties at the same time that oil and gas prices started on their escalating course—a course which since 1972 has multiplied tenfold the market value of crude oil and natural

gas. As a consequence of rising cash bonuses for increasingly valuable federal resources sold in larger quantities, competition for leases further declined and major oil company domination was further enhanced (JA 41-42).

Inadequate public return, weak bidding competition, and major company domination of OCS lease acquisitions were thus demonstrated by the time of the 1978 statutory reforms. They were central themes in the Congressional hearings and subsequent Committee Reports.

B. The Congressional Hearings

Congressional consideration of the OCSLA revisions commenced in the 93d Congress, when the Senate passed a bill in 1974 which provided, inter alia, for changes in the bidding system (see H. Rept. 94-1084, at 70-71 and H. Rept. 95-590, at 95). In the 94th Congress, the Senate passed a comprehensive bill (S. 521) providing for new methods of OCS leasing to be used in at least half of frontier area sales. The House meanwhile had created a special Ad Hoc Select Committee on the Outer Continental Shelf to consider a variety of major OCS reform proposals, and the House passed a bill to this end, H.R. 6218. A Conference Report issued on Sept. 20, 1976 but the Congress terminated without taking action (see H. Rept. 95-590, at 96-98).

Numerous hearings were held between 1975 and 1977 before the committees of both houses (see S. Rept. 95-284, at 68-70 and H. Rept. 95-590, at 95-100). A central theme of the testimony by proponents of reform was the low level of bonus bid competition, and the capture of most of the cash bonus leases by the major oil companies. The House Reports specifically noted such testimony by New Jersey Governor Byrne, by the American Gas Association, by the Associated Gas Distributors (H. Rept. 95-590, at 117) and by California Lands Com-

mission Chairman Cory (H. Rept. 94-1084, at 249).[3] Furthermore, a series of five GAO reports issued between 1975 and 1978 emphasized doubts about the adequacy of competition for and public returns from bonus bid leasing (Appendix C *infra*, p. 4a).

The testimony of the witnesses persuaded the Congressional leaders. Senator Jackson, a leading proponent of the 1978 amendments, testified that "the net profit-sharing approach offers the greatest or best basis of equity as far as the taxpayers of this country are concerned"

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[3] Governor Byrne testified in 1977 that failures in then existing OCS law and its implementation included a "failure to promote effective competition, and to open up the market for offshore resources to companies other than the oil giants" (Hearings on H.R. 1614 Before the Ad Hoc Select Committee on Outer Continental Shelf, 95th Cong., 1st Sess., pt. 2, at 991 (1977)). He urged the adoption of "alternative techniques that would eliminate the large, up-front bonus bid" in order to increase competition and ensure a "full and fair return to the U.S. Treasury" (*id.* at 994).

Chairman Cory of the California Lands Commission testified that the bonus bidding system had confined to a few large companies competition for offshore production and drilling rights (Hearings on H.R. 6218 Before the Ad Hoc Select Committee on Outer Continental Shelf, 94th Cong., 1st Sess., pt. 2, at 1385-86 (1975)). He supported the flexibility in choice of contracting arrangements provided by the new legislation, commending the specific benefits that had accrued to the State of California from profit-sharing (*id.* at 1392-93).

Spokesmen for both the American Gas Association and for the Associated Gas Distributors urged that competition be broadened by this means to permit the participation of smaller companies (Hearings on H.R. 1614, pt. 2, at 959, 961; and at 1078, 1079; Hearings on H.R. 6218, pt. 1, at 539, 541, 544-45; Hearings on S. 9 Before the Committee on Energy and Natural Resources, 95th Cong., 1st Sess. 395, 400 and 640-41 (1977)). Spokesmen for the Associated Gas Distributors argued that the cash bonus method "severely limits the number of companies which can enter the offshore area" because "there are simply not that many companies that can afford the cost of admission" (Hearings on H.R. 6218, pt. 1, at 541). They urged the use of net profit sharing as promoting competition and assuring the highest return to the public (*id.* at 541, 546).

(Hearings on H.R. 6218, pt. 1, at 371). Chairman Murphy of the House Committee expressed the view that "front-end bonus bids are anticompetitive" (Hearings on H.R. 1614, pt. 1, at 667).

C. The Congressional Reports

In the 94th Congress, reports were issued, and favorable action was almost achieved on bills requiring use of new bidding systems. Senate Report 94-284 (94th Cong., 1st Sess. 37 (1975)) explained:

> "The Committee wants to authorize lease allocation systems that would encourage the widest possible participation in competitive lease sales consistent with receipt by the public of fair market value for its resources. Testimony before this Committee and elsewhere has revealed general acceptance of the proposition that high bonus bids have created a barrier to the entry of small and medium size oil firms to the OCS arena. The Committee believes that net profits share and other arrangements can be effective in shifting government revenue away from initial bonuses and into deferred payments made out of a leaseholder's profits based on actual production of oil or gas."

The House Report (94-1084, at 43) set forth the function of the new leasing systems:

> "At present, the cash bonus system is used almost exclusively. Under that system, in order to win a lease, a company must have vast amounts of capital, and the price to the company is set without full knowledge of the value of the oil and gas in the area. This may reduce competition for offshore leases to the major oil companies and reduce the public return for resources. To increase competition for offshore leases and secure higher returns to the public Treasury, Section 8 of the Outer Continental Shelf Lands Act has been amended to allow the Secretary to use seven other bidding methods based on net profits; royalty; or percentages of a lease area (Phillips

Plan). The Secretary is required to choose the new bidding systems in at least ten percent of all lease sales in frontier areas during the next five years."

When the 94th Congress expired without final action, the legislation was promptly reintroduced in the 95th Congress with no significant change in the new bidding system provisions, and favorable committee reports were soon issued in both houses. Stating (S.Rept. 95-284 at 43) that the bill authorizes new leasing systems "*and require*[*s*] *their use on an experimental basis*," the Senate Report gave this explanation of the new systems (*id.* at 46-47):

> "S. 9 authorizes a wide variety of new bidding systems. These are designed to reduce the front end cash bonus, increase the government's return on actual production of oil or gas, make it easier for smaller companies to enter the OCS development business, and increase the availability of funds for exploration.
>
> Section 205 sets forth procedures for utilizing the various bidding alternatives authorized. These alternatives may not be the "perfect solution". However, they should facilitate entry into the OCS development business of more independent producers and are certainly worth trying on an experimental basis.
>
> In order to assure that these alternatives will be used, the bill limits the Secretary's authority to use the cash bonus-fixed royalty system which has been the historical method of OCS bidding to not more than two-thirds of the tracts offered each year. . . .
>
> Section 205 revises bidding systems to encourage entry of new competitors, especially small independent operators."

As the Senate Report further explained (at 73):

> "The basic thrust of all these new options is to reduce the reliance on large front-end cash bonuses as the means of obtaining a fair price for the public's property. The committee wants to authorize lease allocation systems that would encourage the widest

possible participation in competitive lease sales consistent with receipt by the public of fair market value for its resources. The committee believes that net profits share and other arrangements can be effective in shifting Government revenue away from initial bonuses and into deferred payments made out of a leaseholder's profits based on actual production of oil or gas.

. . .

New paragraph (6) of subsection 8(a) limits the use of the cash bonus bid with fixed royalty systems to not more than 66⅔ per centum of the area offered for lease each year in the regions where there has been no previous development of oil and gas.

. . .

The committee included this limitation to assure that the new leasing systems would be tried."

House Report 95-590 similarly found (at 148) that independent oil and gas producers "presently cannot reasonably assume the risks involved in bonus bidding—paying large cash sums in advance with no assurance of recovery of oil or gas." The Report noted (at 138-39) that "[w]itnesses before the committee indicated that the high front-end bonus bids may have created a barrier to the entry of small and medium-sized oil firms as well as other potential exploiters, to the OCS activity, and that these types of bids do not, after the completion of exploitation of a lease area, provide a fair return to the Government." [4]

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[4] Similar to that finding was a contemporaneous explanation in a memorandum to the Secretary of Interior from the Deputy Assistant Secretary on August 15, 1977, at 4-5, attached to defendants' June 23, 1980 Motion for Summary Judgment:

"There is considerable support for this [bonus bidding] system by the larger oil companies. This is the case for several reasons:

. . .

However, a number of shortcomings of the present cash bonus bidding system have been identified. These include the following:

The Report thus concluded (at 54) that "there is now doubt whether cash bonus bidding remains the best system for the future" and explained that one purpose of H.R. 1614 *"is to authorize alternative leasing arrangements and require experimentation with them."* It emphasized (at 47) that the new leasing systems were intended to "increase competition for off-shore leases":

> ". . . At present, the cash bonus system is used almost exclusively. Under that system, in order to win a lease, a company must have vast amounts of capital, and the price to the company is set without full knowledge of the value of the oil and gas in the area. This may reduce competition for offshore leases to the major oil companies and reduce the public return for resources. To increase competition for off-shore leases and secure higher returns to the public Treasury, section 8 of the Outer Continental Shelf Lands Act has been amended to allow the Secretary to use other bidding methods based on net profits; royalty; or work commitments stated in dollar amounts. The Secretary is required to choose the new bidding systems in at least 50 percent of all lease sales in frontier areas during the next 5 years . . ."

Further explanation (at 50) of the new bidding systems was given as follows:

> ". . . many elements of the energy industry will now have an opportunity for involvement in OCS

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1. Many of the smaller and even some of the medium-sized firms limit their participation because of the high risks associated with the loss of their cash bonus if a tract is dry.

2. Those firms that do participate can be expected to submit bids that are considerably less than their estimates of the true value of the tract. They do this to take into account the fact that if they win the tract, they will have been the most optimistic bidder, i.e., they may have made the biggest error in overestimating the tract's value. Also, this strategy provides the winning firm with an additional return to cover the cost of considerable risk that it must bear at a royalty rate of only one-sixth."

activities. New bidding systems, reducing the need for large up front bonus payments, should allow more companies to secure OCS leases and allow all companies to use capital to explore resources."

Finally the Report (at 139-40) made clear the intended "mandate" to test systems other than bonus bidding, to compare the results with bonus bidding:

> "It was the intention of the committee that there be a clear mandate given to the Secretary to require him to use bidding systems other than the cash bonus bid . . .
>
> . . . the committee desired not to give preference to any class or type of bidders for any lease tracts. Some witnesses were concerned that use of bonus bid systems or nonbonus bid systems by the Secretary in any particular area might effectively bar aggressive competition.
>
> By selecting the 'best tracts' for offering under bonus bid systems, or for offering under nonbonus bid systems, he could limit the ability of some companies to participate in lease sales for these 'best tracts.' To avoid such a possibility, the committee, in paragraph (6) required that, generally, he randomly select those areas to be offered under a bonus bid system and those which would be offered under a nonbonus bid system.
>
> . . .
>
> The obvious intention of the committee in revising the procedures for use of new bidding systems is to determine what system or systems, in what situations, provide the best means to lease our federal resources in the Outer Continental Shelf. Subsection (a) is intended to provide procedures to answer this question. In addition to mandating use of new systems, to insure they are tested and studied, and to providing for random selection, to insure fair tests and studies, this subsection details four additional techniques to insure use of the best systems in the best places."

Randomization was not approved in conference, but the Conference Report (H. Rept. 95-1474, 95th Cong., 2d Sess. 92 (1978)) specified that:

> "Although there is no requirement for random selection, the Secretary, in setting forth systems for use on tracts, shall seek to secure a fair selection of different methods on different tracts. The purpose of such a selection is to assure that adequate information is obtained as to relative advantages and disadvantages of the various bidding systems, including the front-end bonus bid systems, as applied to different types of tracts, having different expectations of the amount of hydrocarbons that can be recovered."

Finally, in mandating new leasing systems which minimize front-end bonuses that inhibit competition and smaller company access, Congress disclosed the specific intent to end domination of leasing policy by the large oil companies. Noting (at 54) that "federal administration of the leasing program and federal regulation of offshore oil and gas development have been essentially a closed process involving the Secretary of the Interior and the oil industry," the House Report concluded (H. Rept. 95-590, at 103):

> "It is today's reliance, and tomorrow's dependence on OCS resources that demonstrates the need to reform OCS procedures and to provide new protections.
>
> The committee found that the present law's grant of total discretion to the Secretary led to a situation where the petroleum industry had until recently, as will be discused later, a too dominant voice in the setting of policy.
>
> . . .
>
> It is clear that the pattern of Government-industry relationships which have been developed, produced a very closed system for making and administering OCS policies. It is the closed character of this system which is being challenged at the present time.

> Witnesses this year confirmed this conclusion and further stressed that this dominant voice was, in fact, limited to the larger oil companies. Under the present law's bid system, representatives of the American Gas Association testified the larger energy companies were able to totally dominate leasing."

Soon after this expression of Congressional concern, a memorandum of October 31, 1977 to Interior Secretary Andrus from the Deputy Under Secretary warned of the big companies' dislike for and their power to delay utilization of new bidding systems (J.A. 261).[5] This DOI memorandum was prophetic. Four years since its warning was given and three years since the new statute was enacted, the Department of Interior continues to use *exclusively* bonus bid leasing, thus violating the clear requirements of the 1978 amendments.

D. The Secretary's Violation of the Law

The statutory text and its consistent legislative history repel the Secretary's contention that he has discretion to refuse to test any of the three non-bonus bidding leasing systems among the six systems Congress specified for use in the experimental program. For the discretion left the Secretary was not *whether* to test promising new leasing systems, but only *where and when* to apply a

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[5] The memorandum stated that "There is no question and no dispute about who was responsible for the Rules Committee's action [delaying action on H.R. 1614]—the major oil producers. It is a rather timely follow-up to the President's comments on their role in the Senate on the energy legislation. In my view, despite all the rhetoric about "nationalized oil" and "delays," what the big companies really dislike in H.R. 1614 is new bidding systems. If they can delay enactment of the bill past March, after the George bank and South Atlantic sales, they will have bought the first three prime frontier offerings on the east coast (including Baltimore Canyon) under primarily bonus bidding. You may recall that in the Baltimore Canyon Sale, Exxon, bidding alone, won fully one-third of the leases sold." It is noteworthy that of the 15 companies that appeared in 1981 to file protests against DOE's proposed profit share bidding regulation, 14 firms were among the nation's twenty largest oil companies.

particular new system to particular lease areas and tracts. Thus, the House Committee (*supra*, p. 18) noted its intention by the new bidding systems "to determine what system or systems, in what situations, provide the best means to lease our federal resources in the Outer Continental Shelf." The Conference Report (*supra*, p. 20) similarly explained that in requiring "a fair selection of different methods on different tracts" the intent was to assure that adequate information is obtained "as to relative advantages and disadvantages of the various bidding systems, including the front-end bonus bid systems, as applied to different types of tracts, having different expectations of the amount of hydrocarbons that can be recovered." These expressions confirm the Government's own conclusion (Brief, at 16) that the Secretary has "*discretion in determining when and where to make use of alternative systems . . . .*" But they nowhere suggest that the Secretary also has discretion not to use half of the six new bidding systems, including all those that do not use cash bonus bidding as the method of lease award. Far from any such discretion not to experiment, we demonstrate that both the command to test and the clearly expressed objective of that command preclude the Secretary's renunciation of non-bonus bidding:

i. *The Secretary is violating the statute's express direction that the new systems "shall be applied" for five years.* The statute and the legislative reports bar the Secretary's renunciation of all non-bonus bid leasing during the experimental period, for they both define the new leasing systems and compel their use. The command of 43 U.S.C. § 1337(a)(5)(B) that the new systems "*shall be applied*" for five years, is buttressed by repeated emphasis in the Congressional reports on the compulsion to use the new systems. At the outset, the Senate Report explains that the legislation authorizes new leasing systems and "*requires their use on an experimental basis*" (*supra*, p. 15). The Report goes on to emphasize the intent "*to assure that these alternatives will be used,*"

and *"to assure that the new leasing systems would be tried"* (*supra*, p. 16). The House Report was to the same effect, explaining that the bill's purpose was to authorize alternative leasing arrangements and *"require experimentation with them"* (*supra*, p. 17), thus *"mandating use of new systems, to insure they are tested and studied"* (*supra*, p. 18). The Conference Report (H. Rept. 95-1474, at 92) equally emphasized that the new bidding systems *"are to be utilized"* in all OCS areas for five years. This clear Congressional mandate for broad experimentation with the new bidding systems entirely repels the Secretary's renunciation of all three of the six new bidding systems not based on cash bonus bidding.[6]

Moreover, the Secretary is also nullifying the expressed Congressional intent that the experimentation include a comparison of results from bonus bid and non-bonus bid leasing. The House Committee emphasized

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[6] The floor debates equally indicate that Congress intended to require the Secretary to experiment with the alternative leasing systems. Rep. Brown, an opponent of the experimentation mandate, stated at 124 Cong. Rec. H425 (daily ed. January 31, 1978):

> "In the place of the bonus bid system, the legislation would require the Secretary of the Interior to experiment with seven new systems and in addition would allow the Secretary to establish any other bid system at his discretion."

Rep. Murphy, Chairman of the committee and floor manager of the bill, stated at 124 Cong. Rec. H189 (daily ed. January 25, 1978):

> "H.R. 1614 would provide alternative leasing arrangements and would require the Department of the Interior to use them during the next 5 years so that we may work out the best arrangements for the future."

Another Congressman indicated that, in his understanding, the Act would be "requiring that a variety af new leasing arrangements be tried, in lieu of the traditional cash bonus system." 124 Cong. Rec. H286 (daily ed. January 26, 1978) (remarks of Rep. Gonzalez). "We have clearly stated that Congress wants the Secretary to try in a meaningful fashion the alternative bidding systems." 124 Cong. Rec. H426 (daily ed. January 31, 1978) (remarks of Rep. Hughes). See also citations by the lower court, Petition for Certiorari, App. A at 33a, n.70.

that for comparison purposes the Secretary was to select areas "to be offered under a bonus bid system and those which would be offered under a non-bonus bid system" (*supra*, p. 18). The Conference Report similarly emphasized that the purpose of the mandated "fair selection of different methods on different tracts," was to assure that adequate information is obtained "as to relative advantages and disadvantages of the various bidding systems, including the front-end bonus bid systems . . ." (*supra*, p. 19). The Secretary's renunciation of all non-bonus bid systems precludes the congressionally intended comparison of the results of bonus bid and non-bonus bid leasing.

The Secretary's violation of the specific testing requirements of the experimental leasing program is thus clear. In addition, as we next point out, the Secretary's refusal to use non-bonus bidding also defeats the chief statutory objective underlying the mandated experimentation.

ii. *The Secretary is defeating the Congressionally-specified objective of the experimental program.* The House and Senate reports repeatedly expressed doubts about the adequacy of lease competition under bonus bidding (because the large front-end bonus requirement tends to exclude smaller bidders), and emphasized that the testing of new methods was to promote increased bidding competition and permit smaller firms to participate on the OCS (see *supra*, pp. 14-18). As the court below concluded (see Petition for Certiorari, App. A at 41a) the new non-bonus bidding systems "when tested may prove unsatisfactory, but it is not credible that the Secretaries can permissibly reject them out of hand, when the statutory history is explicit regarding Congressional interest in maximizing competition and encouraging 'the widest possible participation' in lease sales." In totally rejecting testing of non-bonus bidding systems, the Secretary is rejecting the very systems which could achieve the Congressional objective of increasing bidding compe-

tition and smaller bidder access. For it is those options that eliminate the onerous front-end bonus requirement which Congress found to limit the number of bidders and restrict success for smaller companies. As conceded in DOE's recently published regulation for profit share bidding (46 Fed. Reg. 29681), which Secretary Watt refuses to use:

> "In amending the OCSLA to provide for new bidding system alternatives, Congress intended, in part, to encourage greater competition for OCS leases. . . . The variable net profit share bidding system may in practice encourage more participation in OCS lease sales by a more diverse range of firms. Participation in OCS lease sales may be viewed in terms of an increase in the overall number of bids in an OCS lease sale, in the number of bids per tract, or in the number of sale participants. In the sense that greater participation may be considered a measure of competition for OCS leases, this regulation should lead to increased competition." [7]

Moreover, examination of the fourteen OCS lease sales held by DOI since the adoption of the 1978 amendments—all using varieties of cash bonus bidding—shows that cash bonus bidding varieties have yielded no improvement either in the competition for leases or the success rate of the smaller bidders (see Appendix A *infra*, p. 1a). The fourteen sales have used 1) bonus bidding with 16⅔% royalty, 2) bonus bidding with sliding

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[7] Similarly, DOE has recently recognized competition enhancing virtues of the work commitment bidding system, which the Secretary of Interior likewise refuses to use. In DOE's regulation for that system it states (46 Fed. Reg. 35623):

> "DOE's analysis indicates that in certain cases, on a tract by tract basis, use of the variable work commitment bidding system may enhance competition. In moderate cost regions where high cash bonus bids have been perceived as representing a barrier to entry for small firms, use of the variable work commitment bidding system with a low-fixed cash bonus may stimulate competition."

scale royalty, 3) bonus bidding with 33⅓% royalty and 4) bonus bidding with fixed profit share. The overall result has been no better than pre-1978 bonus bidding . The average number of bidders per tract offered was 1.71 before 1972, 1.26 between 1972 and 1978, and is 1.6 since 1978; average bids per tract "bid upon" were 3.5 and 2.77 before compared to 3.0 since 1978; and the top 20 oil producers who captured 80% of the pre-1978 leases have acquired 80.6% since 1978. What is shown by the overall results of continued bonus bid leasing since 1978 is also shown for each of the four varieties of bonus bidding which DOI has used (see Appendix A *infra*, p. 1a).

In sum, as one would have expected, varieties of bonus bid leasing used by DOI since the 1978 Amendments have shown the same low levels of competition and the same domination by the largest oil producers which induced Congress to mandate the program of experimentation with new bidding systems to induce improvement. The Secretary's refusal to test the new non-bonus bid systems leaves the statute's experimentation mandate in shambles. The central purpose of the testing program—whose adoption involved the creation of a special committee in the House, voluminous hearings in both houses, and the concurrence of both houses in two consecutive Congresses before the legislation was finally adopted in 1978—will go for nought if the Secretary's stonewalling succeeds.[8]

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[8] In answer to the clear violations demonstrated, the Solicitor General suggests that the "plain meaning" of the statute bars grant of relief. But far from a plain meaning to grant unrestricted discretion to the Secretary, the statute and the reports both expressly state that the new systems "shall" be used in a broad experimental program comparing the results of bonus and non-bonus bidding. Moreover, this Court has frequently refused to construe statutory text in a manner which would defeat the basic purposes of the legislation disclosed by the legislative reports. As recently as last April a "plain meaning" contention by the same Department was rejected in *Watt* v. *Alaska*, 101 S.Ct. 1673, 1677-78 as follows:

Indeed, the Secretary's nullifying stance violates even the expressed intent of the Executive Branch. Prior to the enactment of the legislation Secretary Andrus repeatedly promised that DOI would make full resort to the new leasing systems (see Petition for Certiorari, App. A at 27a, n.60 and 44a, n.91). In supporting the 1978 legislation the President stated that the amendments would require a flexible leasing program "using bidding systems that will enhance competition" and provide other public benefits (H. Rept. 95-590 at 115). The Executive Branch having expressed its concurrence in the new legislation, and having promised to test new bidding systems in full for the improvement of competition in leasing and other intended benefits, the present Secretary's effort to abort the experimental program is specially inappropriate. As a party to the enactment of the 1978 reform legislation the Executive is in no position to renege before the courts on its pre-enactment support and its commitments to honor the mandate for full experimentation with the new bidding systems.[9]

"We agree with the Secretary that "[t]he starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (POWELL, J., concurring). See *Rubin* v. *United States*, —— U.S. ——, 101 S.Ct. 698 (1981). But ascertainment of the meaning apparent on the face of a single statute need not end the inquiry. *Train* v. *Colorado Public Interest Research Group*, 426 U.S. 1, 10; *United States* v. *American Trucking Assns.*, 310 U.S. 534, 543-544 (1940). This is because the plain meaning rule is "rather an axiom of experience than a rule of law, and does not preclude consideration of persuasive evidence if it exists." *Boston Sand Co.* v. *United States*, 278 U.S. 41, 48 (1928) (Holmes, J.). The circumstances of the enactment of particular legislation may persuade a court that Congress did not intend words of common meaning to have their literal effect. E.g., *Church of the Holy Trinity* v. *United States*, 143 U.S. 457, 459 (1892); *United States* v. *Ryan*, 284 U.S. 167, 175 (1931)."

[9] The reason for the Executive Branch renig is plain. The big oil companies' passion for bonus bidding is shared by Administrations concerned to maximize present federal revenues through

II.

THE SECRETARY'S REFUSAL TO TEST THE PROFIT SHARE BIDDING SYSTEM IS PARTICULARLY UNJUSTIFIABLE, IN VIEW OF THE STATUTE'S FAIR MARKET VALUE REQUIREMENT

When Congress was dissatisfied with the competitive limitations and public returns from cash bonus bidding, it specified new leasing systems for testing, including the profit share bid system. It thus became the Secretary's duty at the very least to test the one non-bonus bidding system that has been used successfully for a substantial period of time. For more than 30 years the State of California has successfully leased offshore oil and gas properties by the variable net profit share bidding system, one of the new systems specified in the 1978 amendments. The Court of Appeals ruled that the Secretary is required by the statute to test that promising system (Petition for Certiorari, App. A at 44a-46a, 47a, 49a). An additional basis for that duty arises from the statute's requirement that leasing shall "assure receipt of fair market value," for the California profit share bid system has achieved far greater public returns on every dollar of oil and gas recovered than has federal bonus bidding.

Fair public return is one of the goals identified in the 1978 law in Section 102(2) (43 U.S.C. § 1802(2)). While all those goals were to be promoted by the experimental leasing program (see H. Rept. 95-590, at 140), with respect to one of them Congress went further. In addition to the goal "to insure the public a fair and equitable return," in new section 208 (43 U.S.C. § 1344(a)(4)) Congress mandated that "*leasing activities shall be con-*

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front-end payments even if less ultimate revenue results in years after they have left office. The Chairman of the House Committee noted in 1977 the problem "that OMB and others count on revenue from OCS sales as part of their budget process" and that "this 'need for money' has led to opposition to other bidding systems that might eventually provide higher revenue totals, but which would reduce bonus revenues in a particular year . . ." (Hearings on H.R. 1614, at 261).

ducted to assure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government." There is no way "to assure" receipt of fair market value from OCS leasings as long as DOI continues to refuse to test the profit share bidding system which shows prospects for greater federal returns. Since California has long been receiving greater returns from profit share bidding, it is demonstrable that the Secretary of Interior is defaulting on the statute's assured fair value requirement by his refusal to test or use that system.

i. *Enactment of the fair market value provision reflected Congressional doubts whether bonus bidding was yielding a fair public return.* As early as the 94th Congress witnesses had emphasized the inadequate assurances of fair return from bonus bid leasing. Thus, in 1974 Congressman Dingell testified that the investigations of his House subcommittee showed DOI unable to assure " 'that the government received fair value for the (OCS) tracts it leases' " (H. Rept. 94-1084, at 61). The Congress responded to that concern. As stated in House Report 94-1084 (at 78) an "underlying concern of the Committee, which is reflected in various provisions of H.R. 6218, is that the preesnt system provides too many advantages for industry at the possible expense of the taxpayer." The taxpayer loss was highlighted further in the supplemental views of eight committee members (*id.* at 249-50), urging use of new leasing systems in more than 10% of the leases (a position later accepted by the 95th Congress):

> "By requiring a large payment of money, at the outset, the bonus bid has effectively precluded smaller companies from entering the OCS leasing process. Studies by both the Federal Trade Commission and the General Accounting Office have shown that the use of the front-end bonus bid discourages competition. While the legislation also would probihit anti-competitive joint bidding between major companies,

unless the use of the front-end bonus is restricted, the ability of smaller companies to participate in OCS activities will remain negligible.

Moreover, commitment of such large amounts of capital prior to development of a lease senselessly ties up money the lessee ought to have available for speedy exploration of a lease . . .

Coastal states in the business of producing offshore reserves have been using many of the proposed alternative leasing methods for many years with enormous success, as have most foreign producing nations.

Significantly, the rate of return to the states and foreign governments under these methods has been far superior to that received by the U.S. Treasury.

For example, California has received about 48 percent of total gross revenues from production under so-called 'experimental' lease terms, as compared to the 16⅔ percent the Federal government will realize from all but three of the Federal OCS tracts leased off Southern California last December. In the East Wilmington Field, off Long Beach, California, the City of Long Beach, as trustee for the state, has received a 94 percent net profit share of all production. In Indonesia, under similar production sharing agreements, the Indonesian government has received up to 95 percent of all net profits.

There clearly is no reason why the U.S. government cannot do as well for its people as foreign governments and U.S. states have done for theirs when leasing oil and gas properties. In each of these cases, the lessees are the same oil companies which we have been told would refuse to bid for leases under any methods other than the front-end bonus. The record, however, both in the United States and abroad, where these companies have been actively engaged in offshore drilling, belies these claims."

By the time the legislation was later enacted in 1978 with its fair market value requirement, the Comptroller General had issued five relevant reports warning that

there was no assurance of fair return from bonus bidding, because of unavoidable uncertainty about the ultimate value of OCS properties being leased and the low level of bidding competition by the oil companies. See Appendix C *infra*, p. 4a. Indeed, the extent of Interior's unconcern whether the value from OCS leasing inures to the public or to the oil companies was dramatically illustrated in a portion of one of those GAO reports (*infra*, pp. 5a-6a), which explained:

> "Interior is attempting to enhance the competitive climate in Shelf leasing. It is proposing new bidding and data disclosure regulations and is undertaking a review of alternative bidding systems. There is merit to Interior actions to create a competitive environment for lease offers.
>
> Some Interior officials argue that the costs to society of overestimating public resource values are greater than the costs of underestimating resource values. The argument is that if the Government overestimates the resource value of a tract, and the high bid is less than the Government estimates, then the tract usually will not be leased and developed, and the net value of oil will not be recovered. On the other hand, if the Government underestimates resource value, the economic rent of the resource will not be fully captured by the public. However, an Interior official said that this does not mean that the value is lost, only that it accrues to the high bidder (petroleum company) instead of the Treasury. We and others would argue, however, that this is a critical point since these are the public's resources and it is the Government's job to not give them to industry for less than they are worth."

On March 7, 1977, GAO testified before the House Committee as follows (Hearings on H.R. 1614, pt. 1, at 232):

> "For OCS sale No. 35 we found that the Department of the Interior's tract selection and evaluation process was not reliable and that bidding was not generally competitive.

> Tracts were selected for leasing without obtaining adequate information to assess their resource potential and to meet the Department's then existing acreage goal of 10 million acres each year.
>
> . . .
>
> Consequently, decisions to lease tracts were not reliable and could not reasonably assure that the public received a fair market value return for the resources leased."

The last of the five GAO reports (*infra*, p. 8a), issued shortly before enactment of the 1978 amendments, summarized the repeated concern about inadequate return from bonus bid leasing:

> "About 60 percent of the tracts in Sale C1 receiving bids got only one or two bids. For Sale 35 and Sale 40 respectively, about 70 percent and 49 percent of the tracts bid on got one or two bids.
>
> . . .
>
> The high percentage of one and two bid tracts in Sale C1 is, to us, the primary indicator of inadequate sale competition. As stated in our Sale 35 and Sale 40 reports, a competitive leasing program is based on the premise that competition will provide a fair market value return. When competitive conditions do not exist, however, it becomes increasingly important to have reliable tract values to use as the basis for accepting or rejecting bids. When large percentages of the total tracts in a sale receive one or two bids per tract and are minimally valued based on poor information, there can be no assurance that the public received a fair market value return for the potential resources leased." [10]

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[10] On August 15, 1977 a DOI memorandum to the Secretary (see *supra* p. 16, n. 4; Policy Paper at 35) similarly stated:

> "One problem is the inability to determine how well or how poorly we are doing in our attempt to obtain fair market value for specific tracts. While no bid rejection system that is dependent on the seller's pre-sale estimate of an item having an uncertain value can ensure that the item's true value will

Congress gave credence to the GAO reports. The House Committee (H. Rept. 95-590 at 110-11) highlighted GAO's conclusions as follows:

> "The GAO found that because the prelease tract selections and evaluations were based on minimal and insufficient resource information, that the estimates of tract values were unreliable, hence the return to the public based upon the fair market value could not reasonably be assured. A full 84 percent of the tracts offered either showed no resource value, or insufficient resources to sustain profitable operations, some due to the limits of present technology. Potential revenues initially put at $2.3 billion were overestimated fivefold with the final results showing that only 24 percent of the tracts were leased, producing $417 million for the Treasury. The GAO also assailed the competitive aspects of the lease sale pointing out that of 231 tracts only 70 received bids, and the majority of tracts bid on, that is 70 percent, secured only one or two offers.
>
> . . .
>
> The Select Committee considered the criticisms and recommendations of the GAO. As suggested, the passage of H.R. 1614 will ameliorate many problem areas identified by various GAO reports and testimony before the Committee."

The Senate report was even more emphatic. Noting that "all those concerned with revision of the Outer

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be received, it is possible to improve the likelihood of this happening through the use of a well-designed procedure.

A second problem derives from the interpretation of "fair market value." We have argued previously that the efficacy of a leasing arrangement should ordinarily be measured by the magnitude of government receipts. Accordingly, even if the current procedure were successful in encouraging receipt of "fair market value," a different procedure might well be capable of generating a greater amount of government receipts. In fact, it is not likely that the current procedure promotes maximization of government receipts, because the uncertainty of a tract's true value is not incorporated into the analysis."

Continental Shelf Lands Act of 1953 should be aware of the very significant findings" of the GAO, the Report (S. Rept. 95-284, at 60) proceeded to digest the three GAO reports which had already issued. The Senate digest of the 1975 report repeats GAO's conclusion that the OCS leasing programs "[d]o not reasonably insure that a fair market value return is received on lease offers of shelf oil and gas resources" (*id.* at 65). It includes GAO's conclusion (*id.* at 66) that "estimates of tract values were not reliable and could not reasonably assure that the public received a fair market value return from the leases." [11] These Congressional expressions underscore the major importance of the 1978 statute's fair market value requirement.

ii. *The statutory mandate that leasing shall assure fair market value is being violated by the Secretary's refusal to test the net profit share bidding system which has yielded California greater returns than the Federal Government receives from bonus bidding.* Committee members noted (*supra*, p. 29), and the record makes clear (see JA 51-53), that California has achieved 48% participation in the oil and gas yield of its leases awarded by profit share bidding. By contrast, on bonus bid leases since 1972 the Federal Government is receiving less than a 30%, and after 1975 as low as a 21.4% net participa-

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[11] DOI remains unable to evaluate tract resources reliably as a means of assuring fair return from cash bonus bidding. The May 5, 1980 GAO report on OCS Lease Sale 48 found (at 26) that the industry high bids on the sale were *20 times greater* than DOI's presale estimate of cash bonus values. And even the Secretary concedes the inadequate public return from bonus bidding in the presence of large discoveries or price increases. As stated in a May 12, 1980 Secretarial Issue Document on Sale A62 (filed by defendants in the District Court on August 25, 1980) the Department conceded (at 27) that although the emphasis on the front-end bonus "provides the lessor with maximum protection against a dry-hole risk . . . this protection costs the lessor through minimal royalty participation in the gains from unexpectedly large discoveries or price increases."

tion (see J.A. 125-45; 188-91; 206-23). Since each OCS lease sale involves billions of dollars of ultimate oil and gas revenue, when the California leasing system can yield 25¢ more public return on every dollar of oil and gas produced the potential loss from DOI's unaltered bonus bidding course is massive. Under these circumstances the Secretary clearly cannot "assure" fair public return from OCS leasing as long as he refuses to test the bidding system which has proved to yield far greater returns.

This basic claim of violation, asserted by plaintiffs at the very outset of this litigation (see JA 93-96), has never been factually refuted by defendants. True, the 1981 affidavit by DOI official Heintz—upon which Secretary Watt relies for his decision to make no use of net profit share bidding and work commitment bidding (see Appendix B *infra*, p. 2a) predicts that if high profit shares are bid to acquire a federal bonus lease the lessee may not develop the property in full, with the result that there will be reduced production and public returns. But there is no suggestion anywhere in the affidavit that under California's profit share bid system there has actually been incomplete development of leases. DOI's speculative reasons for refusal to use profit share bidding are also answered in the Department of Energy's profit share bidding regulation issued in May 1981 (46 Fed. Reg. 29683-84) which refutes claims that under profit share bidding there would be inadequate development of leases (DOE's conclusions are set forth in Appendix D *infra*, p. 10a).

In any event, Congress looked to the new leasing systems to secure higher returns to the public treasury (see *supra*, pp. 27-28). DOI's speculation about nondevelopment is hardly adequate to exclude from the *experimentation* program a fair test of the non-bonus bidding system which has had long successful use in California, and which Congress included among the experimental systems after hearing the same pessimistic predictions DOI is

now voicing. (See generally testimony of Shell Oil witness Hart, Hearings on H.R. 1614, at 941, 943; testimony of Exxon witness Loftis, *id.* at 1197.) The Secretary's concern that under profit share bidding leases will not be fully developed is the same prediction expressed to the Congress in the testimony of the major oil companies which Congress did not consider sufficiently cogent to exclude profit share bidding from the specified experimental leasing program. As the Court below notes (see Petition for Certiorari, App. A at 43a) Congress was unimpressed by such testimony that variable profit share bidding "would encourage irresponsible bidders" and "discourage perseverance in drilling."

Finally, in § 1337(a)(3) of the law (43 U.S.C. § 1337 (a)(3)), Congress anticipated and solved the very problem of underdevelopment which the Secretary cites, by the provision that the Secretary "may, in order to promote increased production on the lease area . . . reduce or eliminate any royalty or net profit share set forth in the lease for such area." As this was explained in House Report 95-590 (at 136), "Several options provide for minimum royalties and net profit share. It might become uneconomic during later phases of production to exploit resources because of these," so the Secretary "is given authority, after production has commenced, to reduce or eliminate any royalty or net profit shares so as to encourage complete exploitation of the resources in a lease area." Secretary Watt's rationalization for refusing to test profit share bidding thus overlooks the very provision enacted to answer the concern he voices.

In sum, the Secretary's pessimistic conjectures about the system which has yielded greater public returns to California cannot overcome the force of the statute's fair market value requirement. There is no experience in California's long and successful use of profit share bid leasing to support the Secretary's speculation, refuted

even by the Department of Energy's recently published regulation. The very point of the mandated experimental program is to put speculation to the test of leasing. Accordingly, the Court below was correct in requiring the Secretary to make good faith resort to profit share bidding during the remainder of the experimental leasing program, and its ruling should be affirmed.

III.

DEFENDANTS' VIOLATIONS CAUSE TANGIBLE INJURIES TO PLAINTIFFS WHICH GIVE THEM STANDING TO SEEK RELIEF IN THIS ACTION

There is so little merit to defendants' "standing" objections that they briefed them in the Court of Appeals only as an afterthought, following the argument of the case (see Petition for Certiorari, App. A at 51a n.*). As that Court found, respondents more than satisfy the standing requirements articulated by this Court—namely a distinct and palpable injury: and a fairly traceable causal connection between the injury and the conduct challenged in this action. This conclusion applies to each group of plaintiffs in this litigation: (1) the State of California, which is an involuntary partner with the Federal Government in OCS leases of "drainage" tracts; (2) California and the City of Long Beach, which jointly compete with the Federal Government for private company leases of off-shore oil and gas properties; and (3) consumers of oil and gas and of other oil and gas-derived products. Moreover, since each group of plaintiffs has standing in its own right, the finding of standing as to any one group makes unnecessary the resolution of the standing issue as to the others. *Cf. Buckley* v. *Valeo*, 424 U.S. 1, 12 (1976).[12]

[12] We recognize that petitioners have challenged the standing of each category of plaintiffs on both constitutional and statutory grounds. Our presentation focuses primarily upon the constitutional issue because all plaintiffs clearly fall within the zone of interests to be protected by the statute. As to California, as co-

The 1978 OCSLA amendments added a new provision to the statute, 43 U.S.C. § 1349, entitled "Citizens suits, jurisdiction and judicial review." That provision au-

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lessor with the Federal Government, *see, e.g.*, 43 U.S.C. § 1332(4)(B):

> "It is hereby declared to be the policy of the United States that...
>
> (4) since exploration, development, and production of the minerals of the outer Continental Shelf will have significant impacts on coastal and non-coastal areas of the coastal States, and on other affected States, and, in recognition of the national interest in the effective management of the marine, coastal, and human environments—
>
> (B) such States, and through such States, affected local governments, are entitled to an opportunity to participate, to the extent consistent with the national interest, in the policy and planning decisions made by the Federal Government relating to exploration for, and development and production of, minerals of the outer Continental Shelf; . . ."

In addition, receipt by a sovereign state of a fair return for depletion of its resources is a valid legal interest within the meaning of 43 U.S.C. § 1349(a)(1).

As to California and Long Beach as competitors of the Federal Government, the statute sought to protect the interests of governmental entities affected by OCS development. *See* 43 U.S.C. § 1332, *supra*. Certainly the rate of return accruing to State and local lessors, whose activities further another statutory goal, prompt development of the OCS, is one of those interests to be protected.

Finally, as to the consumer plaintiffs, the statute, whose purposes are to increase supply and development of oil and gas in a competitive manner, was enacted in large part for the benefit of those who consume those resources. As the Court below stated (Petition for Certiorari, App. A at 52a, n*):

> "It is even more readily apparent that the consumer appellants have standing to sue for violation of an Act designed to increase competition and to step up utilization of energy resources on the OCS. Consumers are the ultimate beneficiaries of both vigorous competition and greater availability of domestic fuel. Here the consumer appellants contend that appellees' leasing activity causes direct harm to consumers by inflating prices, limiting supplies, and restricting choice on the market. This is the type of economic harm commonly present in consumer based litigation."

thorizes "any person having a valid legal interest which is or may be adversely affected" to seek relief by civil action including a suit "challenging actions or decisions allegedly in violation of, or seeking enforcement of, the provisions of this subchapter, or any regulations promulgated under this subchapter, or the terms of any permit or lease issued by the Secretary under this subchapter . . ." (subsections (a)(1), (6)). This provision was enacted to serve a broad remedial purpose (H. Rept. 95-590, at 161):

> "Subsection 23(a) provides for citizens' suits against any person including any governmental agency (including the Department of Interior or other agencies or departments with regulatory or enforcement authority as to OCS activities), alleged to be in violation of the Act, applicable regulations, or the terms of any lease or permit issued under the Act.
>
> This subsection provides that suits may be brought by 'any person having a valid legal interest which is or may be adversely affected.' Thus, the scope of persons who can sue are those who can show an actual interest that is being negatively affected, or will be negatively affected at a reasonable time in the future. The interest must be discernible and ascertainable. Standing to sue includes not only those who have an economic interest, or who have suffered or will probably suffer a tortious injury, but also those who may have a definable aesthetic or environmental interest. Specifically, the Committee intends that this includes persons who meet the requirement for standing to sue set out by the Supreme Court in *Sierra Club* v. *Morton*, 405 U.S. 727 (1972)."

The House Report (at 52) further emphasized that "citizen suits are authorized by anyone having an interest that can be adversely affected against the relevant government agency or department . . . ." See also S. Rept. 95-284 at 80. The remedial purpose was further underscored by the Senate Report's comment (at 81) that

"The possibility of a citizen suit should help to keep program administrators 'on their toes.'" The California plaintiffs and the consumer plaintiffs each have clear standing to sue under this citizen suit provision, because they are injured in several respects by the Secretary's violations here at issue.

A. The State of Caliofrnia Has Standing as A co-Lessor

California is an involuntary partner with the Federal Government in federal lease revenues from OCS leases in "drainage" situations. When the Federal Government owns one portion of an OCS oil or gas pool and the state owns another, the statute provides that a fair share of the federal revenues from the lease shall be yielded to the state pursuant to an agreement between the parties. See 43 U.S.C. § 1337(g)(4). The very first OCS sale held after this suit was filed (in June of 1979) involved such "drainage" pools, as did the recent lease sale held in July of 1981, and sharing arrangements have been proposed by the Government to California on those sales. See Opposition to Petition for Certiorari, Appendix B. The public record discloses that additional drainage tracts will be leased off the California coast during and after the five year experimental period (see e.g., DOI 1981 Environmental Impact Statement on Lease Sale 68 to be held in June 1982).

When California is thus an involuntary partner in federal leasing off the California coast, it has an obvious financial stake in federal use of a leasing system—such as net profit share bidding—which can yield greater revenues to be shared with the State than the present bonus bidding system.[13] Where one half of an off-shore

[13] Although the 1978 amendments provide for a fair distribution between a co-lessor state and the Federal Government, the distribution requirement merely provides that California will receive its pro rata share of the revenues actually received under the lease. No court could order that California, or any state, receive more than its pro rata share of the royalties received because

pool of oil and gas is owned by California, use of profit share bidding by the Federal Government could net California 12 cents more on each dollar of oil and gas produced. See *supra*, p. 33. When each OCS lease sale involves billions of dollars in projected oil and gas resources, a twelve cent loss for California on every dollar's worth of resources is a large loss indeed. Thus the Secretary's refusal to make any resort to the profit share bidding system denies California the prospects of hundreds of millions of dollars in greater shared federal revenues.

Petitioners claim that California's interest in securing a fair return for the depletion of its valuable natural resources is an insufficient basis for standing in the present cases because the relief respondents seek would not guarantee that the Secretary of the Interior would use a non-cash bonus bid for any drainage pool off the coast of California (Brief at 21). It is not surprising that petitioners fail to cite a single case in support of this proposition,[14] since this Court has made clear that no

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the Federal Government leased the property at a disadvantageous rate. Only by forcing the petitioners to experiment with systems promising greater public returns as Congress mandated, will California be assured of receiving a fair return on *its* resources. *Cf. Consolidated Edison Co.* v. *Montana*, 49 U.S.L.W. 4957 (July 2, 1981).

[14] Clearly, *Simon* v. *Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26 (1976) and *Warth* v. *Seldin*, 422 U.S. 490 (1975), are inapplicable here. In both cases, the Court ruled plaintiffs lacked standing because some independent action of a third party was necessary for the plaintiffs' injuries to be effectively redressed. Here, it is the Secretary of the Interior, *a defendant in this case*, who would decide to use an alternative bidding system in a California "drainage" situation. Additionally, this Court in *Simon* said that the "relevant inquiry is whether . . . the plaintiff has shown an injury to himself *that is likely* to be redressed by a favorable decision" (426 U.S. at 38, emphasis added). No "guarantee" was required. *See also United States* v. *SCRAP*, 412 U.S. 669 (1973) (plaintiffs found to have standing). Certainly the relief sought in *SCRAP* would not have "guaranteed" that the environmental injuries complained of would have been remedied.

such "guarantee" is required. In *Arlington Heights* v. *Metropolitan Housing Development Corp.*, 429 U.S. 252 (1977), the Court recognized that "there can be little doubt that [plaintiff] meets the constitutional standing requirements" although "an injunction [granting the relief sought] would not . . . guarantee that [the project] will be built" (*id.* at 261). Standing was established because "[t]he challenged action . . . stands as an absolute barrier to [the project]" (*id.*). Such is the case here. Although experimental use of alternative bidding systems may not guarantee the use of superior bidding systems for a particular California "drainage" parcel, the refusal to experiment "stands as an absolute barrier" to the use of these leasing systems off the coast of California. Clearly, the State, as co-venturer, has standing to challenge the Federal Government's failure to implement this Congressionally mandated experiment, when such failure stands as a barrier to bidding systems that could provide higher returns to the Federal and State co-lessors.

B. The State of California and the City of Long Beach Have Standing as Competitors of the Federal Government

In cooperation with the City of Long Beach, the California State Lands Commission leases California's offshore oil and gas properties to private companies and receives revenues from production based on a share of net profits, which revenues represent in aggregate nearly 50% of the value of the resources obtained. As is set forth in the verified complaint (JA 86-88), to which defendants have never provided any factual rebuttal or contest, California is strongly disadvantaged in selling its own OCS leases when the Federal Government leases similar tracts on terms much more favorable to the lessees. When the Federal Government continues to sell massive bonus bid leases on the West Coast on a basis that yields to the purchasers a far higher share of the oil and gas produced (as high as 78% in recent years), it seriously

impairs the terms that California can obtain from sale of its own profit share leases. Moreover, there is question to what degree California's lessees will continue to develop the existing leases which provide a lower profit than do federal bonus bid leases; if the Federal Government continues with bonus bidding and large oil and gas reserves are discovered, then California's lessees may prefer to exploit such federal leases. Finally, the revenues California can obtain from its existing leases are endangered when producers on federal properties can market their oil and gas at far lower rates, since they have to yield only 22% return to the lessor instead of the far larger share payable to California under profit share leases.[15]

Petitioners have argued here also that the relief sought would not *guarantee* the competitor-plaintiffs a higher return on their lease sales (Brief at 20-21). But, as noted above, no such guarantee is required. If the Secretary of the Interior is now required to experiment with alternative bidding systems, as mandated by Congress, the Secretary will be in a position to determine which system returns the highest royalty to the public treasury and "it is likely", *Simon, supra*, 426 U.S. at 38, that he will choose such a system. And what is not merely likely but a present fact is that the Secretary's exclusive recourse to bonus bidding leasing, contrary to the statute's mandate to test systems likely to yield greater public returns, subjects California to present disadvantageous competition from unnecessarily generous federal oil and gas leases.

C. Direct Injuries to Consumers Give Them Standing

The Government's inaction in this case has caused the consumer plaintiffs two distinct injuries, both of which Congress sought to prevent by the passage of the 1978

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[15] Petitioners criticize the absence of "factual findings" on the standing issue (*see* Brief at 20-22). But Petitioners presented no evidence in the District Court to challenge plaintiffs' verified allegations of injury and causation.

Amendments.[16] First, the Secretary of the Interior's failure to experiment with alternative bidding systems fosters a continued lack of competition for OCS leases, which results in higher prices to consumers. Congress provided for antitrust policy review by the Department of Justice prior to award of any lease (43 U.S.C. § 1337(c)), and diversification of OCS lease acquisitions to include smaller independent companies was a central stated purpose of the new leasing methods (*supra*, pp. 14-18). This diversification in the acquisition of federal oil and gas resources was obviously for the benefit of both consumers and producers. No less than under the antitrust laws involved in *Reiter* v. *Sonotone Corp.*, —— U.S. ——, 99 S.Ct. 2326 (1979), the statutory violations here give rise to consumer injury and standing to sue. As the Court below properly found (Petition for Certiorari, App. A at 54a) the statute clearly authorizes citizens affected by environmental considerations to bring actions and the consumers here are at least as adversely affected as are members of the public by environmental damage from OCS leasing.

Second, the bonus bidding used by the Secretary has resulted in acquisition of practically all the OCS leases by the major oil producers, who have a long track record of stockpiling the leases rather than developing them. Only last year the Secretary of Interior pointed out that the industry is "holding millions of acres without any

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[16] Petitioners' argument that respondents' assertions of injury and causal nexus are nothing more than "an ingenious exercise in the conceivable" (Brief for Petitioners at 17, quoting *SCRAP*) ignores the fact that it was a specific concern with this form of injury and this very causal connection that prompted Congress to enact the 1978 amendments. Congress imposed an experimentation program "(A) to make [oil and gas] resources available to meet the Nation's energy needs as rapidly as possible, . . . and (D) to preserve and maintain free enterprise competition" (43 U.S.C. § 1802(2)).

sign of an effort to explore those leases." [17] Congress foresaw that the new leasing systems which would bring in smaller producers who do not have the capacity to make massive investments for hoarding would yield faster oil and gas production from the OCS. That is the thrust of the repeated assertion in the Congressional reports that the new leasing systems would promote greater recovery of resources (*see supra*, pp. 17-18, 28-29; and citations by the Court below, Petition for Certiorari, App. A at 31a, n.67).

The Secretary's unlawful failure to use new bidding systems which could yield more rapid oil and gas production by the smaller companies thus provides a second clear form of injury to consumers, who have been subjected in recent years to severe gasoline shortages and are threatened with future shortages. Within the statute's terms, the Secretary's refusal to use new bidding systems which would diversify OCS holdings and help alleviate the prospects of repeated gasoline shortages, clearly threatens the consumer plaintiffs' "valid legal interest which is or may be adversely affected." [18]

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[17] In a DOI release on October 23, 1980, then Secretary Andrus pointed out that "the foreign-owned Shell Oil Company now owns 44 leases offshore, some for a period of four to five years, on which there has been no drilling or development, and industrywide there are nearly 700 leases offshore on which there has been no drilling. Conservatively, these 700 leases, averaging more than 5,000 acres each, constitute a total of 3.5 million acres not yet drilled." The Secretary concluded that "credibility is strained when industry cries out for the leasing of more Federal lands, while at the same time holding millions of acres without any sign of an effort to explore those leases."

[18] *Amicus* and petitioners, see Brief for Petitioners at 24, claim that if the Court finds that status as consumer is sufficient to challenge federal leasing policies, such a finding will significantly delay development of the OCS "in direct opposition to the congressional purpose." Specifically, *Amicus* claims that expedited development was the primary purpose behind the 1978 Amendments (*see* Brief for *Amicus* at 5-12). Our reading of the legislation does not confirm that claim. But, even if it were accepted *arguendo*, the only

In sum, there are multiple injuries and prospects of injury here both to the consumer plaintiffs and the California plaintiffs. One chief objective of the 1978 reforms was to win a greater share of the returns from lessees' oil and gas production. As co-lessors and also as competing lessors with the federal government, the California plaintiffs have a direct stake in achievement of that objective by the required testing of the promising new leasing systems. Another major objective of the law is to increase smaller-company access to the vital OCS resources. The consumer plaintiffs have a manifest stake in the required testing of new systems likely to meet that goal, both because of the product competition benefits which would result and the greater oil and gas production which Congress foresaw as a consequence of more diversified ownership of OCS leases.

Finally, the loss to plaintiffs and the public from the Secretary's refusal to carry out the statute's experimentation mandate is not just on individual leases during the five year experimental period which could yield

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proper effect of a finding of this primary purpose would be to limit the relief available to plaintiffs with proper standing, not a finding that they lack standing. If development of OCS resources is the Act's primary goal, this will determine, through a balancing of the equities, whether or not an injunction should be issued. This is exactly what has happened in the instant case. The district court twice, and the circuit court once, determined that, on balance, an injunction should not be issued. Indeed, the decision by the Court below also supports this in that the Court did not enjoin the issuance of the 1980 leases but rather gave only prospective relief which should not have delayed development.

Finally, the contention that judicial curtailment of the statute's citizens suits right would promote oil development has a hollow ring. Secretary Andrus' public disclosure that the major oil companies are hoarding OCS leases (*supra*, n. 17), underscores that it is precisely the use of bidding systems that would bring in smaller companies—as Congress intended—that would promote faster oil production than the Secretary's unrelenting bonus-bidding course.

more competition, more oil and gas, and more public revenues. There is loss also in the ability to show significant benefits from new non-bonus bid leasing methods which could be utilized in OCS leases scheduled after the present experiment ends. In requiring five years of experimentation Congress was not conducting research for its own sake, but looking for means to improve the results for the remainder of this century in the projected sale of vast untapped OCS lands. When the stakes are so large and the injuries so clear, denial of standing would effectively repeal the important citizens suit provision of the statute. While federal agencies never like to be sued, it is for Congress to determine whether judicial review is available. Here Congress has made it available, so as to keep program administrators "on their toes," and the Court below properly found that plaintiffs have standing to seek relief.

CONCLUSION

When in 1975 the Department of Interior revealed to the GAO its unconcern that immensely valuable OCS properties were being leased to the oil companies without assurance of fair public return (*infra*, pp. 5a-6a), the Comptroller General replied that "these are the public's resources and it is the Government's job to not give them to industry for less than they are worth." Reflecting the same view, and desiring to end monopolization of the OCS by the largest companies, in 1978 Congress mandated a five year experiment to test six new bidding systems. The Secretary's refusal to test any of the three non-bonus bidding systems incorporated in the amendments violates the clear statutory mandate for experimentation and wholly defeats its central remedial purpose. Particularly unjustifiable, in view of the statute's fair market value requirement, is the Secretary's refusal to test the profit share bidding system long and successfully used by the State of California.

Under these circumstances the lower court's order that the Secretary immediately commence the required good faith experimentation was an appropriate vindication of the federal law. With three years of the five year experimentation period already gone, we urge that the Court issue a prompt affirmance of the ruling below.

Respectfully submitted,

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APPENDICES

APPENDIX A

STATISTICS ON ALL OCS LEASE SALES HELD SINCE SEPTEMBER 1978 [1]

Source: United States Department of the Interior, Bureau of Land Management, Periodic Outer Continental Shelf Statistical Summaries

Type of Bonus Bid System	Bids Received Per Tract Offered	Bids Received Per Tract Bid On	Tracts Acquired by Top 20 Producers [2]
16% Fixed Royalty	1.7	3.0	77.0%
30% Fixed Royalty	3.3	4.1	81.8%
Sliding Scale Royalty	1.6	3.0	88.4%
Fixed Profit Share	0.8	2.2	83.1%
POST-1978 TOTALS:	1.6	3.0	80.6%
PRE-1972 TOTALS: [3]	1.71	3.5	80.0%
1972-1978 TOTALS: [3]	1.26	2.77	67%-87%

[1] Sales covered: #65(10/31/78), #51(12/19/78), #49(2/28/79), #48(6/29/79), #58(7/31/79), #58A(11/27/79), Beaufort Sea (12/11/79), #42(12/18/79), #A62(9/30/80), #55(10/21/80), #62(11/18/80), #53(5/28/81), RS-1(6/30/81), #A66(7/21/81). 16% Fixed Royalty used in all sales except Beaufort Sea. 30% Fixed Royalty used only in sales #A62, #62. Sliding Scale Royalty used in all the sales. Fixed Profit Share used in sales #A62, #55, #62, #53, #A66.

[2] Sales #53 and #A66 are not included in Top 20 totals because Interior has not yet accepted the bids on these sales. Data on these sales and on sale RS-1 obtained from Bureau of Land Management Recap Sheets.

[3] Source: JA 41-42, 44.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

Civil Action No. 79-1633

ENERGY ACTION EDUCATIONAL FOUNDATION, *et al.*,
Plaintiffs,

v.

JAMES G. WATT, *et al.*,
Defendants.

AFFIDAVIT

CITY OF WASHINGTON
DISTRICT OF COLUMBIA

AFFIDAVIT OF JAMES G. WATT, SECRETARY OF THE INTERIOR

James G. Watt, being duly sworn, deposes and states the following:

1. As Secretary of the Interior, it is my duty to administer the provisions of the Outer Continental Shelf Lands Act relating to the leasing of the continental shelf for mineral exploration and development. Under Section 8 of the Act, I must determine which bidding system to use when offering OCS leases for sale.

2. Based on current information and analyses, explained in the affidavit of H. Theodore Heintz, Jr., I do not believe the purposes of the OCS Lands Act or the best interests of the nation would be served by the use of bidding systems having either a profit share or a

work commitment as the bid variable. Therefore, absent a judicial mandate to use profit share and work commitment bidding, I do not intend to use these bidding systems in OCS leasing.

/s/ James G. Watt
JAMES G. WATT
Secretary of the Interior

Subscribed and sworn to before me, this 8th day of May, 1981.

/s/ Richard R. Lee
Notary Public

My Commission expires: April 14, 1982.

APPENDIX C

EXCERPTS FROM 1975-1978 GAO REPORTS[1]

The GAO report issued on March 19, 1975 pointed out that in view of the very limited presale information about the value of the oil and gas of the OCS properties, adequate bidding competition is required to assure a fair public return from bonus bid leasing (Outlook for Federal Goals to Accelerate Leasing of Oil and Gas Resources on the Outer Continental Shelf, p. 25):

> "One of the goals of Interior's Shelf leasing program is to insure a fair return to the public from the distribution of minerals from public lands. Before leasing Shelf acreage, Survey evaluates the oil and gas potential of tracts to establish a value for each tract offered. We found that inadequacies in the Government's tract selection and evaluation practices existed even at a 3-million-acre leasing rate. This subject will be covered in detail in a separate GAO report which will be issued early in 1975. To proceed with the projected leasing schedule will mean that the Government's role of protecting the public interest in Shelf lease offers will potentially be jeopardized. Lower quality and/or the lack of evaluation caused by an accelerated leasing program will mean increased reliance on bid competition as the only means to insure that a fair return is received for leased resources."

The *June 30, 1975* GAO report ("Improvements Needed in Determining Where to Lease and at What Dollar Value"), concluded (p. 33) that "The existence, magnitude and economic producibility of oil and gas on the Shelf cannot be definitely determined before drilling.

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[1] The five GAO reports appear as Exhibits 1-5 attached to Plaintiffs' District Court Reply Memorandum of July 14, 1980.

Because of inadequate data and analysis the Federal Government cannot reasonably insure that a fair market value is received in lease sales of Shelf oil and gas resources in which competition is not adequate to protect the public interest." The report detailed the significance of adequate pre-sale valuations of OCS properties, as follows (p. 16):

> "After industry has nominated the tracts they are interested in, and before offering tracts for lease offer, Interior conducts a preoffer evaluation of the resource potential of each tract. This is an independent evaluation of the worth of each tract offered for lease and the estimated value is used as a primary factor in determining the acceptability of industry bids.
>
> The results of overvaluation and undervaluation of tracts are difficult to assess. Tracts overvalued in relation to industry bids might result in turning down a bid even if there appears to be adequate competition. On the other hand, those undervalued would likely be awarded at less than fair value if there is inadequate competition and could be a bargain to the high bidder.
>
> In situations where the market functions well; e.g., when there are many bona fide bidders and the market is truly competitive, there would be no need for a valuation system to develop a presumed market price.
>
> Interior is attempting to enhance the competitive climate in Shelf leasing. It is proposing new bidding and data disclosure regulations and is undertaking a review of alternative bidding systems. There is merit to Interior actions to create a competitive environment for lease offers.

> Some Interior officials argue that the costs to society of overestimating public resource values are greater than the costs of underestimating resource values. The argument is that if the Government overestimates the resource value of a tract, and the high bid is less than the Government estimates, then the tract usually will not be leased and developed, and the net value of oil will not be recovered. On the other hand, if the Government underestimates resource value, the economic rent of the resource will not be fully captured by the public. However, an Interior official said that this does not mean that the value is lost, only that it accrues to the high bidder (petroleum company), instead of the Treasury. We and others would argue, however, that this is a critical point since these are the public's resources and it is the Government's job to not give them to industry for less than they are worth."

The *March 7, 1977* GAO report on OCS Sale No. 35, stated (p. ii) that the DOI's pre-sale tract evaluations "were made using inadequate data," and as a result "estimates of tracts values were not reliable and could not reasonably assure that the public received a fair market value return from the leases." As concerns competition, the report found (p. 30):

> "Competitive leasing programs are based on the premise that competition will provide a fair market value for the product sold. This is only true, however, when highly competitive market conditions exist . . .
>
> Sale #35s' results show a lack of competition. Of the 231 tracts offered only 70 (about 33 percent) received bids and 56 (24 percent) were eventually leased. Additionally, the majority (70 percent) of the tracts bid on received only one or two bids each; of the 56 tracts leased, 36 tracts received only 1 or 2 bids (30 of these tracts had one bid)."

As a basis for the report's conclusion (pp. 41-42) that the leasing procedures used do not provide "an adequate level of assurance that fair market value is received," the GAO explained that "the present system results in the real evaluation of resource potential after the lease sale, a situation we consider contrary to normal business practices of knowing the value of products and services sold."

The *June 28, 1977* GAO report on OCS Sale 40 was released on an expedited basis "because of the need to issue the report before passage of pending OCS legislation" (p. 38). Its repeated theme was that fair value from bonus bid leasing was questionable, because of the limited information about the value of the properties and the low level of bidding competition for cash bonus leases (p. 8):

> "Obtaining additional geologic data with interpretations would help establish a more reliable tract value. These values are used as the basis to accept or reject industry bids. The combination of unreliable tract values with limited bidding competition (70 percent of the tracts bid on in Sale 35, and 49 percent of the tracts bid on in Sale 40 got only 1 or 2 bids) reduces the chances of the public receiving the fair market value return on all tracts for the resources sold."

Similarly, the GAO stated (p. 19):

> "Our March 7, 1977, report on Sale 35, demonstrated that inadequate data existed to properly value the resource potential of tracts in that sale. Our analysis of Sale 40 shows that the Department continued to make tract evaluation decisions without sufficient data and interpretation for analysis. Tract value estimates were speculative and could not reasonably assure that the public received a fair market value

return for each lease offering since inadequate competition existed for about 50 percent of the tracts.

Although the report noted some increase in competition over Sale 35, it warned (p. 27): "the high percentage of one and two bid tracts in Sale 40 still indicates inadequacies in sale competition. As stated in our Sale 35 report, a competitive leasing program is based on the premise that competition will provide a fair market value." GAO ultimately concluded (A. 414) that "operation of the present leasing program is not the best way to develop OCS resources," and brings into question "the public's right to receive a fair market value."

On *June 8, 1978*, shortly before the final enactment of the 1978 amendments, GAO's report on the Lower Cook Inlet Sales reasserted its earlier conclusions (p. 23):

> "About 60 percent of the tracts in Sale C1 receiving bids got only one or two bids. For Sale 35 and Sale 40 respectively, about 70 percent and 49 percent of the tracts bid on got one or two bids.
>
> . . . .
>
> The high percentage of one and two bid tracts in Sale C1 is, to us, the primary indicator of inadequate sale competition. As stated in our Sale 35 and Sale 40 reports, a competitive leasing program is based on the premise that competition will provide a fair market value return. When competitive conditions do not exist, however, it becomes increasingly important to have reliable tract values to use as the basis for accepting or rejecting bids. When large percentages of the total tracts in a sale receive one or two bids per tract and are minimally valued based on poor information, there can be no assurance that the public received a fair market value return for the potential resources leased."

The report summarized the several reports as follows (A. 457):

"In our June 30, 1975, report to the Congress, we stated that the effectiveness of the Department's OCS evaluation program was being hampered by inadequate data and analysis. Because of poor or missing geological data, the Department was conservatively estimating tract dollar values in undeveloped areas. Our March 7, 1977, report on Sale 35 demonstrated that there wasn't enough data to properly evaluate the resource potential of tracts in that sale. Our analysis of Sale 40 again showed that the Department continued to make tract evaluation decisions without sufficient data. And, our analysis of Sale CI also found this same problem with the Department's evaluation process. Tract value estimtaes for Sale CI cannot reasonably assure that the public received a fair market value return for each lease offering, particularly since inadequate competition existed for about 60 percent of the tracts."

APPENDIX D

EXCERPT FROM MAY 1981 DOE PROFIT SHARE BIDDING REGULATION (46 FED. REG. 29683-84)

DOE shares concerns over possible speculation in the use of the variable net profit share bidding system, but not to the extent expressed in the comments. The assumption that speculative bids will be submitted for tracts offered under this bidding system presumes that the associated fixed cash bonus will be established at levels low enough that speculators will be relatively indifferent to its loss if the tract proves valueless, as a number of comments mentioned. A speculative bidder considering whether to bid an inordinately high net profit share must weigh the consequences of obtaining an OCS lease encumbered by such terms. The expected rate of return on a lease with a high net profit share term might well be critically reduced, with the result that the tract might well become an unattractive candidate for assignment or farmout. Development might be uneconomical, unless other tracts overlying a field are unitized. Since the variable net profit share bidding system virtually eliminates the prospect for unusually large profits to lessees, and the risk of faulty bidding remains, there appears little justification for apprehension that this regulation will foster waves of speculative bidding.

Both DOE and DOI are cognizant of the possibility of speculation under the variable net profit share bidding system, and intend to cooperate to eliminate such speculation as does occur. While DOE agrees with the comment that manipulation of the capital recovery factor for specific leases will not deter speculators from bidding, other means of eliminating or at least limiting speculation, and its undesirable effects, are available. Prior to an OCS lease sale, fixed cash bonuses must be established for each tract offered under the variable net profit share bidding system. The level of these cash bonuses may be set sufficiently high as to deter speculative bids.

It should also be noted that the Secretary of the Interior is under no obligation to accept bids for OCS leases, and may in his discretion reject the high bid on any tract.

Moreover, pursuant to section 5(a)(7) of the OCSLA, DOI has promulgated regulations to "assure prompt and efficient exploration and development of lease areas," in 30 CFR Part 250. DOI may be expected to enforce these regulations against speculative lessees . . . .

The comments were generally critical of the probable effects of a variable net profit share bidding system on OCS exploration and development. As already mentioned, many respondents indicated their belief that the use of a net profit share term as the bid variable devalued resource evaluation prior to lease issuance, with consequent delays in exploration and development. It becomes advantageous to the lessee then to postpone as much exploration activity as possible until after lease issuance when capital recovery treatment is available.

Other comments cited a lack of incentive for rapid exploration and development in the absence of a high cash bonus, or "sunk cost," to spur operations on a variable net profit share OCS lease. Since at the time of lease issuance the lessee's only tangible investment in a variable net profit share lease is the fixed cash bonus, there is a lack of inventive to recoup that investment, relative to work commitment bid leases, cash bonus bid leases, or other high front-end investments that promise a comparable return on investment. This lack of incentive allows the lessee to focus on alternative investment opportunities, on the OCS or otherwise, and to premise exploration and development activities on successful operations on tracts adjacent or nearby. Such waiting delays development and production; in the event that adjacent tracts are not proven, the lessee may never undertake any exploratory activities. Under such circumstances, even well-intentioned operators may find it beneficial to act speculatively. However, a supporter of variable net profit share bidding asserted to the contrary, that OCS

tracts leased under this bidding system would be explored and developed at least as diligently as tracts leased under a cash bonus bid system.

DOE takes serious note of these possible effects of this regulation, but discounts the likelihood of their widespread occurrence. Left to themselves, lessees might act in the manner described in the comments. However, the OCSLA and implementing DOI regulations have given DOI powerful means to enforce compliance with the general provisions of the OCSLA and of leases issued pursuant to the statute. These means include exploration plans, development and production plans, fines, lease forfeiture, and prohibitions on participation in future OCS lease sales.

. . . .

DOE shares these concerns [about sustained production], as its own analysis yields similar results. As a means to mitigate partially these anticipated drawbacks to use of this bidding system, DOE notes the availability of capital recovery treatment for allowable exploration and development costs.

Before any net profit share payments are owned to the government, the lessee is entitled to recoup all its allowable costs, plus an additional percentage of such costs incurred during the capital recovery period through application of the capital recovery factor. Assuming a technically producible field, the ability to recoup costs may provide some incentive to complete development and initiate production. This ability might postpone the point at which the lessee considers production uneconomic. Also, the lessee always recoups all of its allowable costs, whenever incurred during the life of the lease, though the election to end the capital recovery period is irreversible.

Other than incentives provided by the ability to recoup costs, DOE again points out the existence of enforceable DOI regulations relative to prompt exploration and development of leases and the requirement for a lessee to file exploration and development and production plans.